

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
45 Fremont Street  
San Francisco, California 94105**

**NOTICE OF PROPOSED EMERGENCY ACTION  
PURSUANT TO INSURANCE CODE SECTION 12921.7 AND  
GOVERNMENT CODE SECTION 11346.1**

**DATE:** May 17, 2010

**REGULATION FILE:** ER-2010-00001

**LIFE SETTLEMENT REGULATIONS**

**OPPORTUNITY FOR INTERESTED PARTIES TO SUBMIT COMMENTS TO THE  
OFFICE OF ADMINISTRATIVE LAW**

Paragraph (a)(2) of Government Code section 11346.1 requires that, at least five working days prior to submission of the proposed emergency action to the Office of Administrative Law, the adopting agency provide notice of the proposed emergency action to every person who has filed a request for notice of regulatory action with the agency. After submission of the proposed emergency action to the Office of Administrative Law, the Office of Administrative Law shall allow interested persons five calendar days to submit comments on the proposed emergency regulations as set forth in Government Code section 11349.6.

**EXPRESS FINDING OF EMERGENCY**

**AUTHORITY AND REFERENCE**

The proposed regulations will implement, interpret and make specific the provisions of Insurance Code sections 10113.1, 10113.2 and 10113.3 (Stats. 2009, ch. 243 sections 1-10(SB 98)). Insurance Code sections 10113.2(k) and 10113.35(a) provide authority for this rulemaking, as do the following decisions of the California Supreme Court: *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989), and *20<sup>th</sup> Century Ins. Co. v. Garamendi*, 8 Cal. 4<sup>th</sup> 216 (1994).

**INFORMATIVE DIGEST; DESCRIPTION OF THE PROBLEM AND THE NECESSITY FOR  
THE REGULATION**

**Summary of Existing Law**

Signed into law on October 11, 2009, SB 98 (Calderon) gives the California Insurance Commissioner jurisdiction to regulate life settlements. SB 98 also simultaneously repeals the Insurance Code's viatical settlement provisions, which are codified at Insurance Code, sections

10113.1 and 10113.2. While the effective date of SB 98 is January 1, 2010, SB 98 provides that its provisions “shall not apply to any life settlement contract entered into on or before July 1, 2010.” Stats. 2009, ch. 243, § 8. Thus, the practical effect of this provision is to give the Commissioner an opportunity to adopt emergency regulations prior to SB 98 actually applying to life settlement transactions.

A life settlement is a contract in which an owner of a life insurance policy assigns his or her policy to a third party for consideration that is less than the policy’s death benefit. Ins. Code § 10113.1(k). The original owner of the policy is thus relieved from making further premium payments, and the new owner acquires the policy as an investment and will receive the policy’s death benefit upon the death of the insured. Life settlements require the exchange of sensitive confidential medical and financial information, and are a transaction that is primarily entered into by or on behalf of elderly or sick insureds.

SB 98 constitutes a comprehensive regulatory scheme for life settlements, including the imposition of licensing requirements. That is, “providers” or those entities entering into a contract with an owner of an insurance policy must be licensed by the Commissioner, as well as life settlement brokers, or those persons who, for a fee negotiate a life settlement agreement between a provider and a policyowner. Ins. Code §§ 10113.2(b)(1), 10113.1(b). With respect to the new licensing category of “life settlement broker”, SB 98 allows life producers who have been licensed in California for at least one year to notify the Commissioner of their transaction of life settlement business. Ins. Code §§ 10113.2(b)(1)(D)(i) and (ii). Individuals who do not qualify to broker life settlements in this manner need to complete 15 hours of life settlement continuing education (CE) in order to meet the qualifications to apply for a life settlement broker’s license. Ins. Code § 10113.2(b)(1)(A).

SB 98 allows for the grandfathering in as life settlement providers and brokers those viatical settlement providers and brokers whose licenses were in good standing at year-end 2009. Ins. Code § 10113.2(b)(1)(C). It also has a provision enabling life settlement brokers and providers lawfully transacting life settlement business in California prior to the effective date of SB 98 to continue to do so, as long as they file their applications for a license within 30 days after the Commissioner’s publication of the application/s. Ins. Code § 10113.3(u). Thus, providers and brokers previously lawfully transacting life settlement business in California may continue to do so pending the Commissioner’s review of their applications. (With respect to life settlement brokers, SB 98 imposes the additional requirement that they have transacted life settlement business for at least one year prior to the effective date of SB 98. Ins. Code § 10113.3(u).)

At the heart of SB 98 are consumer protection provisions. Both providers and brokers must comply with strict consumer disclosure requirements. For example, the provider must disclose all commission paid in a transaction, and brokers are required to disclose all of the offers received on a policy sought to be sold, among other disclosures. Ins. Code §§ 10113.2(d), (e) and (f). In addition, the new law imposes restrictions on the frequency and manner in which insureds can be contacted by providers after the consummation of the life settlement transaction. Ins. Code § 10113.2(d)(11). SB 98 also imposes protections for the insured’s confidential medical and financial information, requiring the exchange of information to be limited to persons involved in

the settlement transaction, and only with the insured's consent. Ins. Code §§ 10113.2(d)(10), 10113.2(g) and 10113.2(h).

The law also imposes provider escrow and provider records retention requirements. Ins. Code §§ 10113.3(j), 10113.2(t). SB 98 requires life settlement providers to file an annual statement with the Insurance Commissioner reporting important information about their transaction of life settlement business. Ins. Code §10113.2(p). SB 98 contains a comprehensive list of fraudulent life settlement practices, and grants the Commissioner the broad power to investigate, examine or discipline a provider or broker. Ins. Code §§ 10113.1(g), 10113.3(s), 10113.2(l), 10113.2(m) and 10113.2(b)(2). The Commissioner may also issue cease and desist orders and monetary penalties against licensees. Ins. Code §§ 10113.2(n) and 10113.2(o).

SB 98 includes important provisions designed to curb the transaction of "STOLI" or "stranger originated life insurance." The latter is an arrangement to initiate the issuance of a life insurance policy for the benefit of a third-party investor who, at the time of the policy's origination, has no insurable interest in the life of the insured. Ins. Code § 10113.1(w). Pursuant to SB 98's amendments, these sales violate the insurable interest provisions of the Insurance Code, as well as laws prohibiting the wager on a life. Ins. Code §§ 10110.1(d) and 10110.1(e). SB also authorizes an insurer to make specific inquiries of prospective insureds to detect unlawful STOLI schemes. Ins. Code §10113.2(i). In addition, SB 98 includes "entering into stranger-originated life insurance" as a fraudulent life settlement act. Ins. Code § 10113.1(g).

## Policy Statement Overview

The purpose of the proposed regulations is to implement SB 98. SB 98 requires those involved in a life settlement transaction to be licensed, but does not have specifics on how this is to be accomplished. The license categories created by SB 98 include life settlement provider, and life settlement broker. As to the latter, life producers complying with a notification procedure do not have to take CE, while other life settlement brokers do. Although applications are required for obtaining licenses in these categories, SB 98 is not specific on what the applications are to contain, or what the fees should be. SB 98 is also silent on specific procedures for the grandfathering in of those currently licensed as viatical settlement providers and brokers, as well as when the sale of an interest in a provider triggers a new licensing requirement.

Similarly, SB 98 contains a general requirement for all licensees to file life settlement forms with the Commissioner prior to their use, but offers no specifics on how this is to be done. The new law contains a provider annual reporting requirement, but offers only general parameters on what the report can and cannot contain. SB 98 also lacks specific on the appropriate format for the life settlement provider's verification of coverage form. SB 98 spells out provider records retention requirements, but is silent on the subject for brokers.

SB 98 allows providers to transfer an interest in a life settlement to a financing entity or purchaser, even though there is no licensing requirement for the latter. SB 98, however, is silent on whether the provider has the obligation to notify the insured when a policy has been transferred and the identity of the new owner. Further, while SB 98 allows an interest in a life settlement to be

transferred to a purchaser who is not an original party to a life settlement contract, it contains no measures providing for the protection of that investor; this is a key omission in light of the Commissioner's experience with senior citizens being marketed risky investments of this nature.

The goal of the proposed regulations is thus to fill in the gaps of SB 98 and prescribe comprehensive procedures for the regulation of the life settlement industry that are efficient, fair, and balance the interests of the consumer with those of the industry.

### Effect of Proposed Action

The proposed regulations define comprehensive procedures for the licensing of life settlement providers and brokers, and contain specific application forms. The Commissioner expects life settlement brokers to comprise the majority of the applications to be received under the new law, and the proposed regulations provide for an online application procedure. The proposed regulations also define procedures for the grandfathering in of viatical settlement providers and brokers and address issues such as at what point a sale of an interest in a provider triggers an obligation to file an application for a new license, and when a license must be surrendered because it is not being used. The proposed regulations give added clarity and specificity to SB 98's provider escrow requirement for the protection of consumers in a life settlement transaction.

In addition, the proposed regulations include a procedure for licensees' compliance with SB 98's requirement for them to file all life settlement forms prior to their use. The latter entails a simple online procedure. The proposed regulations also prescribe records maintenance requirements for providers and brokers.

SB 98 contains lengthy and comprehensive consumer disclosures, and the proposed regulations provide suggested templates that can be used by licensees for their convenience and for the benefit of California consumers. Also for the protection of consumers, the proposed regulations require providers to inform the insured of any subsequent transfers of the purchased life insurance policy to another party.

The proposed regulations implement SB 98's requirement for providers to file an annual statement, and the regulations include the annual statement form, along with the requirement that providers file an audited financial statement along with the annual statement.

In the Department of Insurance's experience, the financial exploitation of small, individual investors has been a major problem in the marketing of viatical settlement investments, particularly to senior citizen investors. The proposed regulations address this issue by requiring those marketing life settlement investments to make a reasonable determination that the investor falls under the appropriate exemption in the California securities laws' registration requirements. In addition, the regulations require compliance with a comprehensive list of disclosures to the prospective investor.

Finally, SB 98 includes the requirement that providers use a verification of coverage form approved by the Commissioner, and the proposed regulations include a suggested template for this form.

Comparable Federal Law.

There is no existing federal statute or regulation that is comparable to the proposed regulations.

#### MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The proposed regulations do not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with section 17500) of Division 4 of the Government Code would require reimbursement.

#### COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES OR SCHOOL DISTRICTS OR IN FEDERAL FUNDING

The Commissioner has determined that the proposed regulations will result in no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of the Government Code, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

The Department will incur costs relating to the general implementation of SB 98. Such will include those relating to processing provider and broker applications and enforcing the statute, as well as adapting the Department's online filing procedures to handle the influx of life settlement provider and broker applications. Based upon the Department's projections of the number of new provider and broker applications, the Department estimates that it will require an additional \$405,000 for fiscal year (FY) 2010/11 to fund two additional attorney positions, as well as support implementation related tasks in the Department's Statistical Analysis and Informational Division. The Department anticipates requiring \$298,000 per year to implement SB 98 in fiscal years following 2010/11. It should be emphasized, however, that these costs are ultimately derived from SB 98, and not directly from the implementing regulations. They are also based upon the Department's projections, and actual experience may prove the estimates to be too low or too high.

#### DESCRIPTION OF SPECIFIC FACTS DEMONSTRATING THE EXISTENCE OF AN EMERGENCY AND THE NEED FOR IMMEDIATE ACTION; DESCRIPTION OF THE JUSTIFICATION FOR ADOPTION OF THE REGULATION AS AN AMERGENCY REGULATION

SB 98 explicitly gives the Department emergency rulemaking power. Specifically, Insurance Code section 10113.35(a) provides, in pertinent part "the adoption or amendment of the regulations required to be adopted pursuant to this article *is an emergency* and shall be considered by the office of Administrative Law as necessary for the immediate preservation of the public peace, health and safety and general welfare." (Emphasis added.)

The Department has historically regulated viatical settlements, and until the passage of SB 98, had no jurisdiction to regulate life settlements. However, while unregulated in California, the life settlement market has grown significantly in the last decade. SB 98 allows those life settlement

providers and brokers currently lawfully operating in the unregulated market to continue to do so, as long as they file their applications within 30 days of the applications' availability by the Department. Ins. Code § 10113.3(u). SB 98 applies to life settlement transactions beginning in July 1, 2010; therefore, it is urgently necessary for the Department to have a comprehensive regulatory framework in place prior to the statute's July 1, 2010 effective deadline. Otherwise, prospective licensees will have to struggle to comply on their own with the new law, only to then have to become familiar with the Department's life settlement application and procedural requirements. This will require their preparation and use of two sets of forms, one that they have created on their own, and another in order to comply with the Department's implementation of SB 98. This would impose a grossly inefficient process on prospective licensees that ultimately could destabilize the life settlement market and not be in the best interest of prospective licensees or consumers.

## STUIDES AND REPORTS

The Department has relied upon no technical, theoretical, and empirical study, report, or similar document in connection with this action.